

**WOOLWORTHS GROUP PLC  
COMPLETED ACQUISITION OF BERTRAM GROUP LIMITED  
THROUGH ENTERTAINMENT UK LIMITED**

**STATEMENT OF CASE**

**1. INTRODUCTION AND SUMMARY**

1.1 In referring this case to the CC, it was clear that the OFT's principal preoccupation was with the effects of the merger upon independent retailers<sup>1</sup>.

1.2 While acknowledging that the CC has a duty to consider all those implications of the merger that might bear upon its competitive effects, the parties share the OFT's view that:

- (a) *Larger retailers* such as retail chains, book clubs, supermarkets and internet retailers obtain a large volume of their stock using direct supply<sup>2</sup>. They appear not to be concerned by the merger. Given their lack of concerns and their views that direct supply could be (if it was not already) a constraint on wholesalers, the consequences of the merger for those groups of retailers need not be considered further<sup>3</sup>;
- (b) Even on a "cautious" approach to market definition<sup>4</sup>, treating wholesale supply to *libraries* separately from wholesale supply to retailers, there is a negligible overlap between the parties in such supply. There are several other significant suppliers in the segment, the market is still relatively fragmented and the parties could not profitably sustain a price increase or significant worsening in their terms of service to customers<sup>5</sup>;
- (c) The transaction raises no competition concerns of a *vertical* nature<sup>6</sup>, given Woolworths' extremely small share of the retail book market<sup>7</sup>.

1.3 The parties' responses to the Market and Financial Questionnaires provide detailed data on the above issues and the parties see no reason for the CC to depart from the conclusions reached by the OFT. The parties are, of course, happy to provide such further evidence as the CC may require in order to satisfy itself.

1.4 This Statement of Case accordingly has as its focus the position of independent book retailers post-merger.

1.5 This is not to say, however, that the parties would recognise "the wholesale supply of books to independent retailers" as constituting a meaningful relevant

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<sup>1</sup> See the OFT's Woolworths/Bertram decision dated 3 April 2007 (*OFT decision*).

<sup>2</sup> Throughout the Statement of Case, a reference to "direct supply" means the supply of books to a retailer by a primary distributor or publisher.

<sup>3</sup> OFT decision para 44.

<sup>4</sup> OFT decision para 25.

<sup>5</sup> OFT decision para 49.

<sup>6</sup> OFT decision para 87.

<sup>7</sup> OFT decision para 86.

product market. Just as, at the retail level, consumers' book-buying patterns make it difficult to define separate markets according to outlet type, so the buying behaviour of the retailers themselves is by no means uniform. It should, however, be common ground between the parties and the CC that:

- (a) Almost all independent retailers use a mixture of channels (direct and wholesale) to meet their requirements; and
- (b) Discussions of "switching" should therefore focus on the ability and incentive to increase the proportionate use of one channel at the expense of another, as opposed to whether one channel is dropped entirely.

1.6 Against that background, the parties would tend to favour an approach to market definition based on the common features in the supply of all books through all distribution channels to all retailers (in particular the ease of supply side substitution), while recognising that the analysis of competitive effects of the merger may require separate assessment in terms of broad retailer type.

1.7 The parties are unsurprised that a number of independents are nervous about the implications of the merger. Looking at the environment within which an independent retailer has to compete, it is understandable that they feel strongly about additional changes to the competitive landscape. In particular:

- Independents are already suffering as a result of the channel pricing imposed by publishers, which ensures that neither direct supply nor supply through a wholesaler can provide them with the discounts necessary to match chains, supermarket or internet retailer prices;
- Independents have seen their market share decline over the last few years as a result of the intense competition at retail level. Many independents have had to close and others are struggling to survive;
- Independents have witnessed considerable consolidation at the publisher level, which has strengthened publisher resolve to refrain from varying the channel pricing structure.

1.8 While instinctive suspicion is therefore understandable, in many cases it simply reflects the fact that independents in a vulnerable position are likely to "fear the worst". However, the evidence presented below indicates that there is no reason to "fear the worst" as retailers are no worse off from the merger because their ability to negotiate better terms of supply is not materially affected. Indeed, any benefits obtained by the merged entity in the form of more attractive discounts as a result of increased bargaining strength would expect to be re-invested in both better services and terms provided to customers.

1.9 This paper (and the additional information that will be provided in response to the Market and Financial Questionnaires) will show that the quality of service and price competition currently enjoyed by independent retailers will not diminish post-merger. Indeed, it would be (and always has been) the intention of the parties to use their increased strength to negotiate harder with publishers to obtain discounts which are consistent with the volumes being purchased.

1.10 It is important to note that regardless of the merger, final book buying consumers are ultimately protected by:

- the strength of downstream competition in the retail market from chains, the internet and supermarkets, which means that independents cannot pass-on worse terms of supply to final consumers by reducing either discounts or non price aspects of competition (such as range and service quality); and
- the fact that, since most titles sold by independents are sold at the RRP printed on the cover by publishers, independents cannot pass on worse terms to consumers by increasing prices.

1.11 This point is fundamental: competition in the retail market protects final consumers and provides a constraint on wholesalers upstream. The constraint is unchanged following the merger.

1.12 On the contrary, given the inability of independents to pass on inferior terms of supply it is highly likely that a strategy of reducing discounts would speed up the decline of the independent sector. It is highly unlikely that the parties could regain this lost business from other distribution channels. Adding to this the substantial share of business accounted for by the independent segment within the parties' businesses, it is clear that no incentive to embark on such a strategy exists.

1.13 Given the tough environment within which independent retailers are forced to compete, the parties hope to be able to reduce the discount "gap" between the deals currently being offered to supermarkets and the deals currently being offered to trade wholesalers (and therefore to independent retailers who use wholesalers). There is evidence to suggest that this objective is realistic:

- Prior to the hold separate undertakings being imposed by the OFT, EUK re-negotiated its supply arrangements with [X] on behalf of the combined EUK/THE/Bertram group. The negotiations led to an improved discount being agreed between the parties. However, as soon as the hold separate undertakings were imposed this agreement was revoked by [X];
- When Bertram decided that Bertram Library Services (*BLS*) would obtain better discounts purchasing from Bertram Books, rather than through direct supply, the publishers threatened [X] sanctions on the business in an attempt to force Bertram to reverse its decision. However, as other library wholesalers moved to a similar supply model to take advantage of the better discounts on offer, the publishers were forced to accept the change.

1.14 Although the parties are now unable to negotiate on behalf of the combined group, they have already made it clear to their independent customers that they intend to provide them with better deals if the merger is allowed to go ahead. For example, combined Bertram and THE customers have already been moved on to the better of the two businesses' combined discounts.

1.15 Crucially, conditions in the book supply market will ensure that a combined Bertram/THE will continue to face strong competitive pressure to offer the best prices and services to all of its customers, including independents. This Paper will show that:

- as between wholesalers to independents, Gardners is Bertram's closest competitor, with THE a distant third and that the counterfactual does not indicate that these relative competitive positions would have been different absent the merger (see **Section 2**);
- direct supply by publishers is an effective constraint and critically so for a retailer's secondary supplier option in a world where, for the reasons set out in Section 2, the parties are not each other's closest competitors for the primary supply role (see **Section 3**);
- the evidence on demand and supply side substitution is compelling for the inclusion of direct supply in the relevant market. Even taking a cautious, narrow market definition that focuses only on the supply of new books to independents, direct supply accounts for at least 50% of the market – substantially in excess of the [X] [20-30]%<sup>8</sup> combined pre-merger share of the parties (see **Section 4**); and
- accordingly that, while barriers to entry are not high (see **Section 5**), the lack of an SLC resulting from the merger does not depend upon new entry, but rather derives from the continued presence of substantial constraints in both primary and secondary sourcing decisions, combined with the effectiveness of downstream competition in protecting consumer interests (see **Section 6**).

## 2. CLOSENES OF COMPETITION BETWEEN WHOLESALERS

2.1 This section considers the competitive constraint that the merging parties place on each other, relative to the constraint that Gardners places on each party. The evidence supports the contention that Bertram and Gardners are each other's closest competitors:

- (a) Gardners is a stronger constraint on Bertram than is THE (i.e. Gardners constrains Bertram more effectively than THE constrains Bertram); and
- (b) Gardners is no less effective a constraint on THE than is Bertram and probably a stronger constraint by virtue of its greater range (i.e. Gardners constrains THE more than Bertram constrains THE).

2.2 Put differently, to the extent that any independent uses the threat to switch to THE as a way to obtain better terms from Bertram, a more powerful threat remains to switch to Gardners. Likewise, to the extent that any independent uses the threat to switch to Bertram as a way to obtain better terms from THE, an equally (if not more) powerful threat remains to switch to Gardners.

2.3 In stating that Gardners is a stronger constraint on Bertram than is THE, this is not to suggest that independents currently dealing with THE are irrational and/or fail to obtain a valuable service. Instead, we are presenting evidence which shows that THE is not a driver of competition in range, price or service quality and, as such, the removal of THE as an independent supplier has no material impact on these factors because they will be determined by the effective competition between Gardners and the merged firm (and competition from direct supply).

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<sup>8</sup> [X]

2.4 In the remainder of this section, we consider:

- the extent to which there is any *product differentiation* between the offers of Bertram, THE and Gardners. There is *little differentiation*, low switching costs, high price sensitivity and no material capacity constraints – i.e. a situation exists where independents are very well placed to play Bertram and Gardners off against each other to obtain competitive terms of supply;
- the characteristics of Bertram, Gardners and THE. To the extent that differentiation exists, *THE emerges as a weak competitor*;
- direct evidence on closeness of competition. In terms of competition among wholesalers (i.e. ignoring the important role of direct supply), Bertram win-loss data confirm that *Bertram and Gardners are closest competitors*, with THE a distant third. Further, survey evidence on Bertram customers' choice of second supplier demonstrates the importance of Gardners and direct supply, and the considerably weaker role for THE;
- the *counterfactual*. The evidence does not support the view that absent the merger THE would have grown its range to match that of Bertram and Gardners. Given (a) the THE business model with its greater focus on supplying supermarkets (which require a narrower range); (b) the relative fragility of the independent segment; and (c) the relatively low margins earned by THE relative to its margins on other lines of home entertainment business; it is not likely that substantial resources would have been devoted to expanding the THE book range absent the merger.

***Wholesaling to independents is broadly homogenous and switching costs are low***

2.5 The OFT viewed wholesaling to independents as broadly homogenous: “... *the basic service provided to independent retailers, although slightly differentiated, is in many respects very similar. This is particularly so between Bertram and Gardners.*”<sup>9</sup> The OFT implicitly acknowledged that Gardners is Bertram's closest competitor on account of both wholesalers having relatively large ranges.

2.6 Since wholesalers are not highly differentiated (other than by range which, as we explain below, is where Gardners performs best) we would expect switching from the merged entity to Gardners to be straightforward. This is because with broadly identical products, this is not a case involving a “cost” of moving to an inferior or “less preferred” product.

2.7 In terms of price sensitivity, it is notable from the win/loss data (addressed in more detail from para 2.27 onwards) that independents are active in negotiating better terms and willing to switch for relatively small improvements in those terms:

- (a) Of the [X] accounts lost by Bertram to another wholesaler because of pricing issues (as opposed to service) where information is available, customers were offered increased discounts of [X] percentage points on average.

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<sup>9</sup> OFT decision para 79 (emphasis added).

- (b) Of the [X] accounts won by Bertram because of improved discount terms, the average increase in discount was [X] percentage points.
- (c) On average, Bertram had to offer increased discounts of [X] percentage points to retain customers that threatened to switch.

2.8 It should be noted that these examples understate the degree of switching because they focus on account closures (or the threat to close accounts), while it is more usual to switch substantial volumes without closing an account. Nonetheless, they are representative in terms of the price sensitivity of independents.

2.9 Further, the parties are aware that independents source some titles from supermarkets and the internet where these can be obtained more cheaply than from wholesalers (see the response to question 9 of the Market Questionnaire). Such "arbitrage" is further evidence of price sensitivity.

2.10 In short, independents are active in negotiating better discounts and willing to switch for relatively small changes in price. The Bertline and THEsis IT systems provided to some customers by Bertram and THE allow customers to submit their electronic orders to any other wholesaler<sup>10</sup>. An independent customer could thus switch all their supply requirements to another wholesaler without replacing their existing system, implying a very low switching cost.

2.11 A survey of over 200 Bertram independent customers (carried out in the normal course of business in January 2006) indicated that at least [X]% of Bertram customers already had accounts with Gardners<sup>11</sup>. Such multi-sourcing facilitates switching, as does the fact that Bertram and THE independent customers have no notice periods and no committed volumes. The minimum carriage-free order value is £100 RRP for Bertram (and £75 at wholesale value for THE – which is broadly the same value as £100 RRP), which matches that of Gardners and is broadly the maximum threshold for other publishers and distributors (with the majority being much lower or non-existent).

2.12 Bertram does not face capacity constraints and so the merged entity will have the ability to increase sales without facing any substantial investments or disproportionate increases in incremental costs. The parties believe that, given its superior warehouse capacity and stock availability, it is very unlikely that Gardners faces capacity constraints either.

2.13 The high degree of multi-sourcing, the low minimum orders and the evidence of price sensitivity are all consistent with the view that switching costs are very low. In markets where services are broadly identical, switching costs are low, there are no material capacity constraints and buyers play off suppliers to obtain better terms, it is likely that competition between the two closest competitors will be very intense (absent collusion, which as we explain below, is not likely to arise). In other words, effective competition between Bertram and Gardners will remain after the merger.

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<sup>10</sup> There are a number of similar systems available other than those provided by Bertram, THE and Gardners. Further detail of these systems will be provided in response to question 32 of the Market Questionnaire.

<sup>11</sup> Bertram Independent Book Survey – 2006.

### *A comparison of closeness of competition on service, range and price*

2.14 The survey of Bertram customers carried out in the normal course of business in 2006 indicated that independents (regardless of their size), consider all aspects of the supply proposition to be important. The results are presented in **Table 1**. The level of service provided by the supplier is ranked as the most important aspect, whilst range and price are generally valued equally. The finding is very similar across different retailer sizes; that is, smaller independents do not value a particular element of supply any more or less than larger retailers.

**Table 1**

<b>First most important aspect of supply</b>					
<b>Annual total book turnover (retail)</b>	<b>Price</b>	<b>Range</b>	<b>Service</b>	<b>Other</b>	<b>Grand Total</b>
<b>Below 150k</b>	30%	31%	37%	3%	118
<b>150k or more</b>	29%	32%	37%	2%	107
<b>Grand Total</b>	29%	31%	37%	2%	225

*Q: Please rank 1 – 3, in order of importance to you the following: Range, Price, Service*

*Source: RBB analysis of the Bertram Independent Bookseller Survey 2006*

2.15 In the following paragraphs, we discuss the extent to which THE is a weaker competitor than both Bertram and Gardners in terms of range, price and service.

#### ***Bertram and Gardners are each other's closest competitors on range, with THE lagging far behind***

2.16 Gardners' superior range means that the most effective competitor on range remains to constrain the parties. Further, Bertram's range encompasses [X%] of THE's range, ensuring that post-merger the overall availability of titles will not materially decline. As such, a substantial lessening of competition (*SLC*) in terms of range is highly unlikely.

#### *THE offers a much smaller range*

2.17 THE is a weak competitor to Bertram and Gardners in relation to the range of titles that it lists and those that it stocks. Its range is significantly smaller: generally it will have around 80,000 titles in stock, whereas Bertram will carry 210,000 and Gardners 250,000 to 300,000, (i.e. Gardners has a 25% - 50% greater range than Bertram and 3 to 4 times the range of THE). There are also large differences in the levels of listed titles: THE have 110,000, Bertram have 532,000 and 700,000 are listed by Gardners<sup>12</sup>.

2.18 Another way to gauge the different levels of stock is to note that an analysis of the (at cost) value of stock in January 2007 suggests that Bertram carries around

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<sup>12</sup> The titles listed and stocked can vary on a monthly basis, so figures are not precise.

£[X] compared to only £[X] at THE, again reflecting the superior range and availability offered by Bertram.

2.19 The depth of range is an important element of the service provided by wholesalers to independent retailers. THE estimates that for the majority of independents at least 20% of sales are customer orders for specific titles which are not in stock at the retailer. For independents who have a good reputation for customer service (which is often the characteristic which will differentiate them from the larger chain stores), customer orders may be far higher than 20%. As THE carries a smaller range it is less able to supply these requirements.

2.20 This impacts THE's sales far more than solely losing out on the sale of the non-stocked title in question. Since independent retailers will inevitably use wholesalers to purchase a "basket" of titles (hence ensuring that they meet the minimum purchase threshold), an independent retailer wanting to purchase a title for a customer order which is not stocked by THE is far more likely to switch this order to Bertram or Gardners, together with a basket of other titles it wishes to purchase, in order to meet the minimum order threshold. In this way, the lack of deeper range titles in THE's range has a much wider impact on THE's sales. (The same applies with direct supply – where a title is available only direct from a publisher, there is a strong incentive to switch other orders to that publisher's primary distributor to meet the minimum order requirement.)

2.21 THE is thus less able to compete in winning and maintaining supply agreements with independent retailers. As such, THE provides a weaker constraint on Bertram in terms of competition on range than does Gardners.

*Bertram's range encompasses the THE range*

2.22 In February 2007 an analysis of the range carried by both THE and Bertram was carried out to assess the range overlap.<sup>13</sup> Of the trade titles that THE had in stock, [X]% were also in stock at Bertram. Of the remaining [X]% of titles available from THE but not Bertram, [X]% were considered inappropriate for Bertram customers (i.e. supermarket focussed titles) and a further [X]% were either unavailable for purchase or Bertram had made a conscious decision not to stock them. (The exercise also showed that Bertram had [X]% of the range of THE.)

2.23 This finding is important. Since Bertram's range almost entirely encompasses THE's range, the loss of THE as an independent competitor will not lead to a narrower overall range of titles on offer. That is to say, the total breadth of titles available to independents from THE, Bertram and Gardners in the pre-merger situation will not be significantly different compared to the post merger situation. In short, the merger will not give rise to an SLC as regards range. Indeed, it is likely that the merger will lead to increased range availability as not only will the number of listed titles increase, but the likelihood of any given title being available to customers will be higher. This arises because THE customers will be in a position to take advantage of Bertram's superior range. In addition, it is anticipated that there will be some cost savings through warehousing efficiencies which will be brought about

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<sup>13</sup> On the date the comparison was carried out Bertram range was [X] and the THE range was [X].

through the closure of the Stoke facility. Consolidated stock holding should lead to better availability for the combined businesses' customers.<sup>14</sup>

***THE does not appear to offer systematically lower prices than Bertram***

2.24 THE does not compensate for its weak range by systematically offering lower prices. An analysis of the average discount provided to customers by both Bertram and THE confirms that there is no significant difference between the discounts offered by the two parties:

**Table 2**

Average discount provided by Bertram/THE		
	Average discount	Weighted* average discount
<b>Bertram</b>	[X]%	[X]%
<b>THE</b>	[X]%	[X]%

*Source: RBB analysis of data provided by Bertram (\* Weighted by value of sales)*

2.25 Whilst we are unable to carry out a detailed analysis of Gardners' discounts, Bertram believes that it faces significantly more price competition from Gardners. For example Gardners has embarked on an aggressive pricing strategy following the Bertram/THE merger announcement<sup>15</sup>. This is consistent with the view that Gardners provides stronger price competition to Bertram than does THE.

***THE does not appear to offer better service than Bertram or Gardners***

2.26 The parties do not have reliable evidence on the relative levels of service offered by Bertram, Gardners and THE. However, to the best of their knowledge, service levels are on aggregate broadly similar. THE is not known to be "better" in terms of service. Further, availability is a key feature of the level of service provided and, as explained above, in this regard Gardners and Bertram perform better than THE.

***Direct evidence on closeness of competition***

2.27 Win-loss analysis confirms that Bertram and Gardners are closest competitors. We also note that the survey evidence on Bertram customers' choice of second supplier demonstrates the importance of Gardners and primary distributors/publishers, and the considerably weaker role for THE.

*Win-loss analysis (Bertram)*

2.28 **Table 3** summarises win-loss data for Bertram since 2004 (this includes all Bertram customers). The data also include examples of terms improvements to retain primary supply position from competitors. This shows that customers are regularly won and lost in response to differences in discounts, non price terms and service

<sup>14</sup> Further details will be included in the response to the Market Questionnaire.

<sup>15</sup> Ibid.

levels. Note that the data picks up only account closures (as explained below). In practice, independents switch much more regularly between wholesalers but where the independent keeps open both accounts this would not be recorded in the data below. Since 2004, of the [X] times Bertram have lost an account, [X]% of these losses have been to Gardners compared to [X]% to THE. Of the [X] accounts won by Bertram [X]% of these have been won at the expense of Gardners, compared to [X]% from THE. Where customers have sought improved terms, [X]% of the time they have quoted Gardners during the negotiation process, [X]% THE. Overall, therefore, the data support the view that Bertram customers regard Gardners as a much closer substitute than THE; of the [X] episodes (a reasonable sample size) where accounts were either won or lost, [X] involved Gardners and only [X] THE.

**Table 3**

Summary – Bertram win/loss from other wholesalers				
	Gardners	THE	Gardners/THE <sup>16</sup>	Sample size
Lost	[X]%	[X]%	[X]%	[X]
Improved terms	[X]%	[X]%	[X]%	[X]
Won	[X]%	[X]%	[X]%	[X]
Sample size	[X]	[X]	[X]	[X]

Source: RBB analysis of the Bertram Win Loss Data

*Win-loss analysis (THE)*

2.29 **Table 4** summarises the win-loss data for THE for the last 30 months. As far as is possible the data has been categorised into the reasons for switching. Again, there is evidence that customers switch between suppliers to take advantage of improved terms and service. Of the accounts lost by THE, [X]% were lost to Bertram, [X]% to Gardners. Of those which were won, [X]% were lost by Bertram, [X]% lost by Gardners. Overall, therefore, of the [X] episodes where accounts were either won or lost, [X] involved Gardners and [X] Bertram consistent with Bertram and Gardners being equally strong constraints on THE.

**Table 4**

Summary – THE win/loss data							
	Bertram	Gardners	Shop openings	Shop closure	Shop purchase	Publishers	Sample size
Losses	[X]%	[X]%	[X]%	[X]%	[X]%	[X]%	[X]
Wins	[X]%	[X]%	[X]%	[X]%	[X]%	[X]%	[X]

<sup>16</sup> This column represents situations where both Gardners and THE are mentioned or where an account is won from a new customer (understood not to have previously used a wholesaler).

Sample size	[X]	[X]	[X]	[X]	[X]	[X]	[X]
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Source: RBB analysis of the THE Win Loss Data

2.30 The data presented above represent occasions when customers have closed accounts rather than switched a substantial proportion of the purchases to another supplier. Bertram and THE may be unaware when customers choose to source titles from other suppliers. This means that Table 3 and Table 4 are likely to understate actual switching as they are only picking up ‘dramatic’ incidents of switching and are not reflecting true switching levels due to multi-sourcing. This explains why data provided by Bertram and THE do not always overlap, for example a Bertram win at the expense of THE may not show as a loss on THE data as THE may not know they have lost the account (residual purchases may remain). For the same reason, we would expect that accounts won and lost to Gardners would also be under-reported and so there is no reason to believe that competition from Gardners is over-stated.

#### Choice of secondary wholesaler

2.31 Independent retailers generally source titles from a number of channels, including direct from publishers (as is explained in more detail below). The survey evidence demonstrates that where Bertram is the primary supplier, Gardners is the most commonly cited secondary supplier ([X]%), closely followed by primary distributors/publishers ([X]%)<sup>17</sup>. **THE is a distant third** at only [X]%. These findings are summarised in **Table 5**.

2.32 The results are consistent across all sizes of retailer. For example, for the very smallest retailers (in terms of annual book turnover), [X]% obtain their secondary supply from Gardners, [X]% from primary distributors/publishers and only [X]% from THE.

**Table 5**

Summary – Secondary supply when the primary supplier is Bertram			
Annual total book turnover (retail)			
Secondary supply when the primary supplier is Bertram	Below 150k	150k or more	Grand Total
Gardners	[X]%	[X]%	[X]%
THE	[X]%	[X]%	[X]%
Publisher/primary distribution	[X]%	[X]%	[X]%

<sup>17</sup> It is important to note that the data analysed will underestimate primary distribution to a significant degree because it asks only about an individual primary distributor and not primary distributors as a whole. In fact, we would expect that if the supply of all primary distributors were aggregated then primary distribution would factor on substantially more than the [X]% of occasions identified

<b>Retailer</b>	[X]%	[X]%	[X]%
<b>Wholesaler</b>	[X]%	[X]%	[X]%
<b>Unclassified</b>	[X]%	[X]%	[X]%
<b>Grand Total</b>	[X]	[X]	[X]

*Q: Please list your top three book suppliers in order of spend*

*Source: RBB analysis of the Bertram Independent Bookseller Survey 2006*

2.33 The evidence is clearly supportive of the proposition that Gardners currently places a greater constraint on Bertram than does THE. Further, as we explore below, the role of direct supply is more important than that of THE. That is to say, ***in terms of competition to be the second supplier to an independent that uses Bertram as its main supplier, there is greater competition between Gardners and direct supply than between THE and Gardners.***

2.34 We also compare the discounts offered by Bertram when the customer is and is not supplied by THE (and vice versa). If THE placed a greater constraint on Bertram than Gardners, Bertram would be expected to offer higher average discounts when THE was present. From **Table 6**, there is no discernable difference in the discounts offered in either case. While this result is consistent with the view that THE and Bertram do not constrain each other to a material degree, we have not been able to control for other factors that impact on discounts.

**Table 6**

<b>Bertram/THE discount</b>	
	<b>Average discount</b>
<b>Average Bertram discount when customer is not supplied by THE</b>	[X]%
<b>Average THE discount when customer is not supplied by Bertram</b>	[X]%
<b>Average Bertram discount when customer is supplied by THE</b>	[X]%
<b>Average THE discount when customer is supplied by Bertram</b>	[X]%

*Source: RBB analysis of data provided by Bertram*

***THE is unlikely to become a stronger competitor in the future.***

2.35 It is unlikely that, absent the merger, THE would have embarked on substantial investments to expand its range and service offering in an attempt to catch up with Bertram or Gardners. There are several reasons for this.

2.36 [X]<sup>18</sup>.

2.37 Secondly, independent retailers account for a large share of wholesalers' business relative to other retail channels. However, the share of the retail market taken by independents is under pressure as a result of increased competition from the internet, chains and supermarkets (see further below at paragraph 6.42). As a result, independents are a vulnerable segment. According to TNS data, the share of independents has declined from 17% in 2001 to 10.7% in 2003 and to 9% in 2006<sup>19</sup> and whilst the independent market share has been static in the past year the downward trend is expected to continue in the future. These features undermine the attractiveness of substantial investment by THE in the independent sector.

### 3. DIRECT SUPPLY IS AN EFFECTIVE CONSTRAINT

3.1 This section examines the extent to which independent retailers have a credible threat to make greater use of direct supply in response to worse terms of supply by wholesalers. It is important to note that for this distribution channel to be an effective constraint, it is not necessary that independent retailers drop wholesalers altogether, but instead that they would have the ability and incentive to switch substantial volumes away from wholesale supply in favour of direct supply should wholesale terms of supply deteriorate.

3.2 The ability of direct supply to act as a constraint on wholesalers is clear:

- (a) Evidence from the Bertram survey shows that for at least [X]% of independent retailers, direct supply provides the second largest source of supply when Bertram is the primary wholesaler, significantly *above* the proportion supplied by THE as a secondary wholesaler. (As noted below, direct supply is understated as the respondent lists only the type of the individual supplier. Had the purchases from primary distributors and publishers been aggregated, the role of direct supply would have been greater.)
- (b) In the Bertram survey of its customers (where it would be expected that Bertram is more often the main supplier), a primary distributor/publisher was the main supplier on [X]% of occasions *above* THE and Gardners (at [X]% each). Further, for low turnover independents, a primary distributor/publisher was the main supplier on [X]% of occasions, compared to Gardners [X]% and THE just [X]%. This is consistent with the view that direct supply is a viable alternative for independents (i.e. as viable as dealing with THE) irrespective of their total turnover in books.
- (c) Multi-sourcing is wide-spread among independents (62% of independents use at least five suppliers, while 88% use at least three). This is consistent with the view that independents are well placed to switch a substantial share of purchases either to an alternative wholesaler or a primary distributor/publisher in the face of worse terms of supply post-merger. Indeed, 56% of independents use at least three suppliers, at least one of which is a primary distributor/publisher, consistent with the view that Bertram customers view direct supply as viable alternatives to wholesalers.

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<sup>18</sup> [X]

<sup>19</sup> TNS data.

- (d) Primary distributors and publishers actively seek the business of independents. Publishers visit independents fairly regularly ([x%] are visited by a publisher, of these [x%] are visited on at least a monthly/twice monthly basis, a further [x%] are visited on a quarterly basis).
- (e) Primary distributors and publishers increase their activity to attract independents at peak time. During the busy Christmas period publishers introduce hotline delivery services (next day delivery), longer opening hours and other special arrangements. This is good evidence in favour of the view that primary distributors and publishers have both the ability and incentive to respond to profitable opportunities (25-27% of the annual expenditure of books occurs in November and December). The same is true of the "back to school" season (August and September), another peak time when a further 15-17% of books are sold.<sup>20</sup>
- (f) Independent retailers that use direct supply typically order a full or mixed range of titles from primary distributors/publishers, including titles from front-list, mid-list and back-list (i.e. in general, independents do not use primary distributors/publishers only for a certain type of book).
- (g) The low minimum order requirements for primary distributors/publishers mean that direct supply is viable. In the same way that it is viable for specialist and academic bookshops to source their needs primarily from publishers (the OFT found examples to support this view), non-specialist independents have exactly the same option. Further, specialist or academic book retailers (i.e. those the OFT found more suited to using direct supply) make up a very important share of the population of independents. Some [x%] [40 to 70]% of Bertram customers could fall into this category.

3.3 Much of the evidence supporting the importance of direct supply draws on the Bertram survey (conducted in the normal course of business in January 2006). This survey is likely to *understate* the use of direct supply as those most likely to have responded to the survey would have sourced a large share of their requirements from Bertram due to the financial incentive offered (5% off Bertram purchases for one order).

3.4 Indeed, the parties estimate that direct supply accounts for at least 50% of the supply to the independent sector, as explained in Section 4.

***Direct supply makes up a high proportion of secondary supply***

3.5 **Table 5** above reveals that around [x%] of customers who use Bertram as their primary source of supply source their second largest amount from an individual publisher/primary distributor. This is the case not only for larger independents, but also for retailers who are small in terms of the revenue generated from book sales. In other words, the survey shows that wholesalers in aggregate are the second supplier on [x%] of occasions, compared to [x%] for just a single primary distributor.

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<sup>20</sup> Further details on the services provided by publishers/primary distributors during these periods will be provided in response to the Market Questionnaire.

3.6 It is important to note that the data analysed will underestimate direct supply to a significant degree because it asks only about an individual primary distributor/publisher and not primary distributors or publishers as a whole. In fact, we would expect that if the supply of all primary distributors/publishers were aggregated then direct supply would factor on substantially more than the [X]% of occasions identified.

***Direct supply is an important share of primary supply – more important than THE for Bertram customers***

3.7 In the Bertram survey of its customers, a primary distributor/publisher was the main supplier on [X]% of occasions, above THE and Gardners (at [X]% each). Further, for low turnover independents, a primary distributor/publisher was the main supplier on [X]% of occasions, compared to Gardners [X]% and THE just [X]%. This is consistent with the view that direct supply is a viable alternative for independents (i.e. as viable as dealing with THE), irrespective of their total turnover in books.

**Table 7**

<b>Summary - First Suppliers of Respondents</b>			
<b>Annual Total Turnover</b>			
<b>Number of Suppliers listed</b>	<b>Below 150k</b>	<b>150k or more</b>	<b>Grand Total</b>
<b>Bertram</b>	[X]%	[X]%	[X]%
<b>Bertram/ Gardners</b>	[X]%	[X]%	[X]%
<b>Gardners</b>	[X]%	[X]%	[X]%
<b>Publisher/primary distribution</b>	[X]%	[X]%	[X]%
<b>THE</b>	[X]%	[X]%	[X]%
<b>Wholesaler</b>	[X]%	[X]%	[X]%
<b>Unclassified</b>	[X]%	[X]%	[X]%
<b>Sample size</b>	[X]	[X]	[X]

*Q: Please list your top 5 book suppliers in order of spend*

*Source: RBB analysis of the Bertram Independent Bookseller Survey 2004*

3.8 The independents who listed a publisher/primary distributor as their main supplier are generally specialist bookshops (for example Christian and academic/educational bookshops). These customers represent an important amount of the sales made by Bertram. Given the diverse nature of the independent sector, defining the difference between a general and specialised independent retailer is difficult, but estimates suggest that [X] [40 to 70]% of survey respondents could be

categorised as specialist retailers<sup>21</sup>. Alternatively, Bertram estimate that [X] [20-30]% of their sales can be characterised as for academic titles.

3.9 Overall, the specialist (including academic) bookshops that are well suited to dealing with (and indeed purchase a substantial share of their needs from) publishers/primary distributors account for a very important source of purchases made by independents.

***Multi-sourcing is widespread***

3.10 In the 2004 survey, respondents were asked to list their five top book suppliers in order of spend.<sup>22</sup> More than half of the retailers questioned – including smaller independent bookstores – listed five suppliers, suggesting a high degree of multi-sourcing. The results are summarised in Table 8 below.

**Table 8**

Number of Suppliers listed (maximum of five)			
	Annual Total Turnover		
Number of Suppliers listed	Below 150k	150k or more	Grand Total
1	10%	1%	5%
2	7%	7%	7%
3	19%	13%	16%
4	13%	8%	10%
5 or more	51%	72%	62%
Sample size	124	133	257

*Q: Please list your top 5 book suppliers in order of spend*

*Source: RBB analysis of the Bertram Independent Bookseller Survey 2004*

3.11 Of the total sample, 62% of respondents used five or more different suppliers, and 88% had at least three. This is consistent with the view that independents are well placed to switch a substantial share of purchases either to an alternative wholesaler or a publisher/primary distributor in the face of worse terms of supply post-merger.

3.12 In the 2006 survey, of the 91% of respondents who do use at least three suppliers, 56% list a publisher/primary distributor as one of their three main sources of supply. Whilst the proportion increases a little with the size of retailer (from 54% to 59%), direct supply is nevertheless important for low turnover retailers: the

<sup>21</sup> Estimates based on whether a retailer lists fiction in its top 3 sales category or whether the top two selling categories are non-specialised.

<sup>22</sup> The 2004 survey is referenced as the nature of the questions differed between 2004 and 2006. Respondents were asked to list only three suppliers in 2006.

majority of the smallest independents have a publisher/primary distributor in their top three suppliers.

**Table 9**

<b>Proportion of respondents who have a publisher/primary distributor as one of their three main sources of supply</b>			
<b>Annual Total book Turnover (retail)</b>	<b>Yes</b>	<b>No</b>	<b>Sample size</b>
<b>Below 150k</b>	54%	46%	123
<b>150k or more</b>	59%	41%	108
<b>Grand Total</b>	56%	44%	231

*Q: Please list your top 3 book suppliers in order of spend*

*Source: RBB analysis of the Bertram Independent Bookseller Survey 2006*

3.13 In sum, the findings on multi-sourcing appear consistent with the view that Bertram customers view publishers and primary distributors as viable alternatives for wholesalers.

***Publishers actively seek sales to independents***

3.14 Publishers have a clear incentive to target independents directly. A wholesaler will seek to sell more books but largely does not mind who publishes them. In contrast, the publisher will seek to sell more of its own titles and thereby values a one-to-one relationship with retailers, in the hope that they can be influenced to stock more of the publisher's books rather than those of competing publishers. This is a key driver behind publishers increasing their direct offers and marketing drives to retailers.

3.15 Survey evidence also supports the proposition that publishers are actively seeking to increase sales to independents. Of the sample of Bertram customers, [X]% of respondents have been visited by publisher representatives. [X]% are visited on a monthly/twice monthly basis, a further [X]% are visited on a quarterly basis. These findings are summarised in **Table 10** and **Table 11**.

**Table 10**

<b>Proportion of respondents who see a publisher representative</b>			
<b>Annual Total book Turnover (retail)</b>	<b>Yes (%)</b>	<b>Yes (Number of respondents)</b>	<b>Sample size</b>
<b>Below 150k</b>	[X]%	[X]	[X]
<b>150k or more</b>	[X]%	[X]	[X]
<b>Grand Total</b>	[X]%	[X]	[X]

*Q: Which publisher representatives do you see? How regularly?*

*Source: RBB analysis of the Bertram Independent Bookseller Survey 2006*

**Table 11**

Frequency of publisher representative visits, if Respondents see a publisher representative						
Annual Total book Turnover (retail)	Weekly/every two weeks	Monthly/every two months	Quarterly	<Quarterly	Other	Sample size
Below 150k	[X]%	[X]%	[X]%	[X]%	[X]%	[X]
150k or more	[X]%	[X]%	[X]%	[X]%	[X]%	[X]
<b>Grand Total</b>	[X]%	[X]%	[X]%	[X]%	[X]%	[X]

*Q: Which publisher representatives do you see? How regularly?*

*Source: RBB analysis of the Bertram Independent Bookseller Survey 2006*

3.16 The findings lend support to the contention that publishers and primary distributors are actively targeting all independents, including smaller customers. This type of behaviour accentuates the constraint exerted on Bertram, Gardners and THE.

3.17 There is also a considerable amount of other evidence which, together, strongly suggests that interaction between independents and publishers/primary distributors is increasing. Increased publisher initiatives are described in detail in the answer to question 7 of the Market Questionnaire. They include:

- (a) In January 2007, **Hodder** sent out a questionnaire to independent booksellers to try and ascertain how these retailers use direct and wholesale supply channels. Through this initiative, Hodder is hoping to improve the service that it - and its affiliated primary distributor, Bookpoint - provide to these customers. Hodder is hoping that the changes it makes will attract more independent book retailer customers to purchase direct.
- (b) **Faber and six other publishers** (the Faber group) has extended its Independent Alliance to over 80 independent book retailers and this number is expected to grow over the coming months. The Alliance will enable these retailers to purchase books directly from the Faber group at significantly increased discounts (similar to those received by the chains) as well as additional volume-based discounts. The retailers will also benefit from the Faber group paying for some of their promotional spend as well as visits from the Faber representatives (Faber is expanding its sales force as a consequence). The initiative has had impressive results, with sales growth of over 23%.
- (c) **Penguin** has stated that it is aiming to help the bookshops to “*compete favourably with other larger retailers*”. One of its initiatives is to improve supply chain efficiencies with independents by moving to EDI (electronic) ordering and using Batch’s<sup>23</sup> electronic payment system. It aims to share the benefits with its independent customers by providing improved terms. These

<sup>23</sup> Batch is a company that manages payments by independent book retailers directly to publishers. Batch is owned by the Bookseller’s Association.

and other technological developments are helping to improve the economics of supplying even the smallest customer.

- (d) **Bloomsbury** and **Random House** are allowing their representatives to negotiate promotional discounts to enable independent book retailers to run 3 for 2 offers to compete against similar offers run by larger chains.

3.18 Further, Bertram, for example, is often asked by suppliers to disclose the customers that the books are being sold to. Bertram refuses to disclose this kind of information because it views publishers as potential competitors for any retailer's business and it is clear that publishers value this kind of information in order to advance their direct marketing strategies. In addition, publishers such as [S&K] refuse on principle to support wholesaler Christmas catalogues, suggesting that their focus is on solely selling direct to retailers at this important time of year.

***Publishers are responsive to increased demand to direct supply***

3.19 It is clear that publishers and primary distributors can and do enhance their service offering in response to profitable opportunities. The best example is at Christmas where primary distributors offer next day delivery (instead of the more usual 2-5 day delivery period). For example, 56 publishers and distributors representing over 80% of the book supply market listed their Christmas ordering arrangements in *The Bookseller* on 5 October 2006. Christmas is an important period for book retailers where it is estimated that around 25 – 27% of the value of annual sales are made in November and December. Some publishers also offer “hot-line” delivery services which offer next day delivery during the academic season. A similar situation arises during August and September, the “back to school” season, which accounts for a further 15-17% of annual sales. In short, at the most important times of the year, primary distributors/publishers act as an important constraint on wholesalers (whether in terms of primary, secondary or tertiary supply).

3.20 It seems reasonable to conclude, therefore, that if wholesalers attempt to reduce the level of discounts offered to independents, then publishers and primary distributors would further increase their efforts to attract independent customers.

***Publishers and primary distributors supply a range of titles***

3.21 In a further survey carried out by Bertram in April 2007, Bertram customers were asked what type of books they purchase from their suppliers.<sup>24</sup> The findings shown in **Table 12** indicate that of the 71 independent retailers who responded, 66 source via primary distribution. Of these, 48% buy a full range of titles (front-list, mid-list and back-list) from publishers and a further 12% buy two of the three categories (i.e. frontlist/backlist and midlist/backlist). Only 24% source only front-list titles (the fast moving new titles range) from publishers.

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<sup>24</sup> Bertram additional survey of customers 2007.

**Table 12**

Primary Nature of Purchase by Channel of Supplier to Independents						
Primary Nature of Service	Supplier bought from					
	Gardners	THE	Other Wholesaler	Publisher	Internet	Supermarkets
Frontlist/ Midlist/ Backlist	53%	64%	48%	48%	18%	18%
Midlist/ Backlist	31%	11%	9%	6%	3%	0%
Frontlist/ Backlist	0%	0%	0%	6%	3%	0%
Backlist	6%	16%	13%	8%	9%	0%
Frontlist	6%	7%	0%	24%	6%	18%
Midlist	0%	0%	0%	0%	3%	0%
Non responsive	3%	2%	30%	6%	58%	64%
Sample size	62	44	23	66	33	11

Source: RBB Analysis of the Bertram Book Customer Questionnaire

3.22 The findings substantiate the view that not only do independent retailers use direct supply to source their supply requirements, but that independents who buy direct from publishers not only buy popular titles from them (front-list), but all types of titles (including mid- and back-list). This supports the view that direct supply places a constraint on wholesalers across all types of title, not just fast moving popular books.

***“Transaction costs” are not prohibitive***

3.23 The OFT put forward the view that the hassle of contracting with many suppliers deters independents from sourcing direct. However, it should also be noted that the OFT found direct supply to be an effective option for some independents as regards the role of primary supplier. The OFT noted that certain specialist and academic bookshops sourced “...all but a small fraction of the books from publishers – the reason for this is the terms offered by publishers compared to wholesalers...”.<sup>25</sup> The OFT implied that independents using direct supply would be specialist or academic book retailers but the OFT did not consider whether such retailers make up a very important share of the population of independents. However, as noted above, some [3<] [40 to 70]% of Bertram customers could fall into this category.

3.24 While specialist independents might need to contact fewer publishers to cover all of their needs, they would still have to deal with substantially more than 10 primary distributors. Yet, for a non-specialist independent, dealing with just four

<sup>25</sup> OFT decision at footnote 7.

primary distributors would allow direct supply to cover 50% of the market<sup>26</sup>. The parties believe that top 6 primary distributors account for around 75% of the books sold in the retail market. This indicates that the alleged “hassle” costs of dealing with many publishers does not inevitably mean that independents will use wholesalers as their primary supplier.

3.25 While the OFT only had a few examples in its survey of 60 respondents, it should be noted that the OFT survey was subject to response bias – i.e. those least likely to use direct supply were most likely to respond. Whilst the Bertram survey was completed by Bertram customers and is thus inherently biased towards them, the results are not invalidated. In fact, as a key issue is to understand the extent to which Bertram customers view Gardners, THE and primary distributors/publishers as close competitors to Bertram, then the survey – which focuses on Bertram customers – is relevant.

3.26 To the extent that response bias exists, the Bertram survey respondents may be unduly weighted in favour of heavy Bertram users – i.e. users more likely to use wholesalers in general and less likely to use direct supply. This is because respondents were offered an additional 5% discount off one order to complete the survey, meaning that customers who order larger volumes of stock from Bertram would gain most from completing the questionnaire. Those independents that were heavy users of direct supply and that used Bertram only for a low share of their purchases may have been less likely to respond. As such, it could be argued that if a more representative sample were to be achieved then there would be an even greater proportion of independents using direct supply.

#### **4. MARKET DEFINITION AND MARKET SHARES**

4.1 In principle, the relevant product market is the supply of new books to retailers and libraries. This reflects the ease of supply side substitution – a supplier to one sales channel has all the necessary assets to supply another sales channel at short notice and without substantial sunk investments. For example, publishers supply direct to all sales channels. Further, a trade wholesaler could easily start to supply libraries and, by the same token, it is straightforward for a library wholesaler to set up a trade wholesaling arm. They have an incentive to do so as this operation should then qualify for the larger trade discounts available under the channel pricing scheme operated by publishers.

4.2 The OFT adopted a highly cautious approach, focussing only on the independent sales channel. In this regard, even if the market were as narrow as the supply of new books to independents, publishers *already* operate in this market. The evidence presented in Section 3 above demonstrates that independents can and do use publishers as a substitute for wholesalers and thus that direct supply *is* a demand side substitute for wholesaling.

4.3 Further, even if demand side substitution were ruled out (which would be inappropriate), it is inconceivable that publishers could be excluded from the market on the supply side. Publishers have all the necessary assets to supply independent retailers – indeed, they already supply most (if not all) of them. To the extent that, on the demand side, certain independents would not view direct supply to be a very close

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<sup>26</sup> OFT decision para 8.

substitute for supply by wholesalers, the main issue would appear to be next day delivery. However, publishers can and do offer next day delivery – their offers of next day delivery during the peak Christmas and "back to school" periods are quintessentially supply side substitution at work. These examples prove that in response to higher demand, publishers will improve delivery times and other services and advertise their services heavily as a viable alternative to using wholesalers.

4.4 The relevant **geographic** market is UK wide (see the answer to question 4 of the Market Questionnaire).

4.5 Without prejudice to the view that supply side substitution is straightforward across all downstream sales channels, the shares of EUK/THE/Bertram and competitors for the supply of books only to independent retailers are summarised in Table 13 below.

**Table 13: Segment Shares for Supply of Books to Independent Retailers**

	<b>Trade Value (million)</b>	<b>Retail Value (million)</b>	<b>Segment Share (%)</b>
Bertram	£[X]	£[X]*	[X] [10-20]
THE	£[X]	£[X]*	[X] [0-10]
Gardners	£[X]	£[X]*	[X] [10-20]
Publishers/Primary Distributors/Others**		£[X]	[X] [50-60]
<b>Total</b>		<b>£[X]</b>	<b>100</b>
<b>Bertram/THE</b>		<b>£[X]</b>	<b>[X] [20-30]</b>

Source: BML (2006) for value of independent book retailer segment, parties' actual sales figures and parties' estimates (for Gardners' sales to independents and average discount). Note: \* presuming an average discount off RRP of 39%. \*\* Others denotes sales via other sources such as other wholesalers and imports.

4.6 In **Annex 1** share data for the wholesale supply of books to all retailers is provided (as requested in the Competition Commission's Market Questionnaire). Shares for the total distribution of books via both wholesale and direct supply channels are estimated in **Annex 2**.

*Competitive assessment and share of supply*

4.7 Even on the "cautious" narrow market definition, EUK/THE and Bertram's combined share of the total book supply to independent retailers will amount to no more than [X] [20-30]%, which is low compared to the percentage of purchases made directly from publishers. Further, as explained in Sections 2 and 3 above (and summarised below in Section 6), Gardners remains as the most important constraint on each of the merging parties, while direct supply constrains the merged firm across the board and, in particular, as a viable source of "secondary" supply. As such, the merger does not give rise to an SLC.

## 5. EASE OF ENTRY/EXPANSION

5.1 It is hardly surprising (in the light of the counterfactual) that wholesale supply to independents would not be an immediately appealing segment to enter, given the strong competition between Gardners, THE/Bertram and direct supply that would exist post merger. But that does not diminish the role of potential entry/expansion as a genuine competitive constraint. Little investment is required to enter into or expand within book distribution if profitable opportunity is identified. To establish an operation akin to that of Bertram, Gardners or THE would require:

- (a) capital investment in assets to provide:
  - (i) the physical warehouse infrastructure;
  - (ii) systems to receive and despatch the product to stores;
  - (iii) personnel (in particular to build and maintain relationships with customers and suppliers);
  - (iv) central management and support services;
- (b) working capital to support the stock investment required.

5.2 Costs would vary depending on whether the new entrant was an existing wholesaler (for example of HEPs or of library books) expanding into the trade book wholesale sector, or a new entrant with no existing wholesale activities. However, in each case the costs, and time to set up the business, would not be significant. The response to question 45 of the Market Questionnaire sets out three cost scenarios reflecting the approximate costs of entry for: (i) a wholly new entrant into book wholesaling; (ii) a new entrant into the books segment, expanding from an existing HEP wholesale base; and (iii) an expansion of a library wholesaler's activities into the trade wholesale book segment.

5.3 The costs have been based on estimated set-up costs for a wholesaler that would be servicing approximately 1% of the total book retailer base (i.e. potentially over 10% of supply to independents). Since wholesalers only represent around 20-25% of book supply to retailers, 1% of the total book retailer base reflects around 5% of the current wholesale share. As the table illustrates, a new entrant would not need to invest more than [X] – and an existing wholesaler moving into books (from HEP or library wholesaling) would not need to invest more than [X] – to establish a stable wholesale presence in the supply of books to retailers. Further details will be provided in response to the market questionnaire.

5.4 The overall start up costs (not all of which would be sunk given that many of the assets could be used for alternative wholesaling activities) are relatively low. While a wholly new entrant would probably spread these costs over supplying several sales channels, not just independents, if the new entrant focussed only on the independent segment and obtained a 10% share of that segment, the start up costs would be around [X]% of annual turnover (at retail value), comprising one-off costs of [X]% and ongoing costs around [X]%.

5.5 The response to question 45 of the Market Questionnaire describes the relative ease with which Handleman and AMS, having been sponsored to enter as supermarket

suppliers, are capable of growing their operations. Other players (including [X]) are either in the course of entering, or considering entry to, the UK book distribution sector. Further, certain internet retailers would be well placed to enter, as they already have the necessary warehousing and distribution facilities in place. Finally, publishers and primary distributors are increasingly active in targeting independents and could establish wholesaling activities without substantial difficulty.

5.6 As explained further in the Market Questionnaire, it is clear that there is recent evidence of dynamism in this industry and that several large, well-financed companies are actively monitoring (if not entering) the industry and are thus likely to observe developments in the independent segment closely, being well placed to enter in response to profitable opportunities should they arise.

## **6. COMPETITIVE ASSESSMENT**

6.1 In the “cautious” scenario adopted by the OFT, some independents are asserted to be reliant on wholesalers for more than 80% of their needs. As explained above, direct supply is an important competitive constraint on wholesalers but, without prejudice to those arguments, it is helpful to explore the OFT view, to identify whether there is any mechanism by which consumers might ultimately be harmed.

6.2 The OFT concern is essentially that there may be many independents that would require a wholesaler as their primary supplier. We acknowledge that many independents would not switch entirely to direct supply and that there is a role for wholesalers as the main supplier to many independents. However, the OFT failed to address three important issues. First, can such “captive” independents be identified? Second, if so, is competition with Gardners sufficient to prevent captive independents paying more as a result of the merger? Third, even if it were possible to force some captive independents to pay higher prices (which is not the case) then is it likely to lead to consumer harm?

6.3 In fact, as the following paragraphs make clear:

- (a) Competition with Gardners protects “captive” independents;
- (b) “Captive” independents are, in any case, hard to identify and offering them worse terms of supply would not be profitable; and
- (c) The merged firm does not have an incentive to harm independents and even in a hypothetical situation where independents could suffer as a result of the merger, it is highly unlikely to lead to consumer harm, due to effective competition in the retail market.

6.4 Finally, we explain that the merger does not give rise to coordinated effects.

### ***Competition with Gardners protects “captive” independents***

6.5 The wholesaling of new books is not a channel in which there is substantial product differentiation, other than the fact that Gardners offers a better range than Bertram and a much better range than THE. The parties estimate that THE carries a range of 80,000, Bertram 210,000 and Gardners 250,000 – 300,000. As identified above there is a high degree of multi-sourcing, minimum order requirements are low and there is a high degree of price sensitivity, indicating that switching costs are very

low. In addition there are no material capacity constraints. In such markets it is likely that competition between the two closest competitors will be very intense. In other words, effective competition between Bertram and Gardners will remain after the merger

6.6 The OFT viewed wholesaling to independents as broadly homogenous. The OFT implicitly acknowledges that Gardners is Bertram's closest competitor on account of both wholesalers having relatively large ranges. This was explained in detail in Section 2 above. There we showed that:

- (a) Gardners is a stronger constraint on Bertram than is THE (i.e. Gardners constrains Bertram more effectively than THE constrains Bertram); and
- (b) Gardners is no less effective a constraint on THE than is Bertram and probably a stronger constraint by dint of its greater range (i.e. Gardners constrains THE more than Bertram constrains THE).

Put differently, to the extent that any independent uses the threat to secure better terms from THE as a way to obtain better terms from Bertram, a more powerful threat remains to switch to Gardners. Likewise, to the extent that any independent uses the threat to switch to Bertram as a way to obtain better terms from THE, an equally (if not more) powerful threat remains to switch to Gardners.

*There is no SLC in terms of price, range or service*

6.7 More specifically, the evidence presented in Section 2 demonstrates that the merger is not likely to give rise to an SLC in terms of price, range or service due to effective competition from Gardners (and primary distributors/publishers).

6.8 First, THE does not systematically offer greater discounts than Bertram and Gardners and customers that had accounts with both of the parties were moved on to the better of the two businesses' discounts (indicative of the need to compete on price with Gardners). THE is not a driver of price competition.

6.9 Second, since Bertram's range almost entirely encompassed THE's range, the loss of THE as an independent competitor will not lead to a narrower overall range of titles on offer. That is to say, the total breadth of titles available to independents from THE, Bertram and Gardners in the pre-merger situation is not likely to be significantly different compared to the post merger situation. Gardners has the best range and THE is clearly not a driver of range competition.

6.10 Third, THE is not a material constraint on Bertram and Gardners in terms of service. There is no evidence to suggest that THE is viewed as systematically offering a better service than Bertram or Gardners. THE is not a driver of service competition.

***Can the "captive base" be identified and harmed?***

6.11 We have explained that competition from Gardners and primary distributors/publishers should be sufficient to prevent an SLC. However, for completeness it is useful to explore further the theory of harm postulated by the OFT. If that theory is correct, the merged firm should be able to identify captive customers. There would seem to be the following theories of possible captive independents:

- independents with a strong preference for using a wholesaler as their "primary" supplier;
- independents with a strong preference for using wholesalers as their primary *and* a secondary suppliers;
- independents with a low turnover in books ("low turnover independents") that would not have sufficient volumes to make much use of direct supply;
- independents that use primary distributors/publishers only for the supply of a certain type of title (e.g. front-list titles); and
- independents that are "loyal" to a particular wholesaler and not price sensitive.

6.12 Further, having identified "captive" customers there would have to be a profitable mechanism to charge those independents more. We explain below that there are fundamental problems involved both in identifying possible "captive" independents as well as offering them worse terms of supply.

***There is no SLC in the contest to be a primary supplier to independents***

6.13 The OFT put forward a view that there may be many independents that have a strong preference for using a wholesaler as their "primary" supplier. However, it is also important to recall the evidence on direct supply, which indicates that some independents use primary distributors/publishers as a direct source of supply. This was summarised in Section 3, although the following points are worth noting specifically in relation to primary supply:

- (a) In the Bertram survey of its customers (where it would be expected that Bertram is more often the main supplier), publishers and a primary distributor were the main supplier on [X]% of occasions *above* THE and Gardners (at [X]% each). Further, for low turnover independents, a primary distributor was the main supplier on [X]% of occasions, compared to Gardners [X]% and THE just [X]%. This indicates that direct supply is a viable alternative for independents irrespective of their total turnover in books.
- (b) The OFT noted that certain specialist and academic bookshops sourced "...all but a small fraction of the books from publishers – the reason for this is the terms offered by publishers compared to wholesalers...".<sup>27</sup> The OFT implied that independents using direct supply would be specialist or academic book retailers but the OFT did not consider whether such retailers make up a very important share of the population of independents. However, as noted above, some [X] [40-70]% of Bertram customers could fall into this category – i.e. a substantial share of independents are of the type that even the OFT acknowledged would be likely to source heavily from publishers.
- (c) It is clear that primary distributors/publishers can and do enhance their service offering in response to profitable opportunities. The best example is at Christmas where primary distributors/publishers offer next day delivery (instead of the more usual 2-5 day delivery period). Christmas is an important

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<sup>27</sup> OFT decision at footnote 7.

period for book retailers where it is estimated that around 25 – 27% of the value of annual sales are made in November and December. A similar situation arises during August and September, the "back to school" season which accounts for a further 15-17% of annual sales.

- (d) The parties estimate that direct supply accounts for at least 50% of the supply to the independent sector, as explained in Section 4.

6.14 In sum, for many independents direct supply will be a meaningful constraint and so it would appear difficult to identify independents that are locked-in to wholesalers as primary suppliers. Further, to the extent that such a "captive" base exists, competition between the merged firm and Gardners will be sufficient to protect independents in terms of range, price and service (as explained above).

***There is no SLC in the contest to be the secondary (or tertiary, etc) supplier to independents***

6.15 It might be argued that even if there is strong competition between Gardners and the merged entity to be the primary supplier, there is scope for a wholesaler to set higher prices (or worse terms) where that wholesaler is the secondary distributor. However, this theory fails on the following grounds.

6.16 First, evidence from Bertram's survey of over 200 independent bookshops (gathered in the normal course of business) demonstrates that when Bertram is the primary supplier, Gardners is the most commonly cited second supplier ([<]%), closely followed by primary distributors/publishers ([<]%), while THE and other wholesalers are way behind ([<]%) and [%] respectively). In other words, wholesalers in aggregate are the second supplier on [%] of occasions, compared to [%] for just a *single* primary distributor/publishers. (The data understate the role of direct supply because the question asks only about an individual primary distributor/publisher and not primary distributors/publishers as a whole. If the contribution made by all primary distributors/publishers were aggregated, we would expect direct supply to factor on substantially more than the [%] of occasions identified.)

6.17 Thus, even if the view is accepted that most independents want their primary supplier to be a wholesaler, the evidence suggests that primary distributors/publishers are important in terms of providing a secondary source of supply (and the same applies if we consider tertiary sources of supply<sup>28</sup>). As explained below, these findings apply whether we focus on all independents or just those independents with a low turnover in books.

6.18 Secondly, as noted above, it is clear that primary distributors/publishers can and do enhance their service offering in response to profitable opportunities (e.g. at Christmas and the "back to school" season). Again, this points to the importance of primary distributors/publishers as an important constraint on wholesalers, both as regards secondary and tertiary supply but also in terms of primary supply during the most important times of the year for retailers.

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<sup>28</sup> In the Bertram survey, [%] of respondents used a primary distributor as their second or third supplier if Bertram was their first supplier.

6.19 In sum, for many independents direct supply will be a meaningful constraint and so it would appear difficult to identify independents that are locked-in to using wholesalers as their secondary suppliers. Further, as explained above, many independents use direct supply as their primary source of supply and so Gardners and the merged entity would compete to be the second source of supply. In short, competition from Gardners and primary distributors/publishers at the secondary, tertiary, etc supplier stage will be sufficient to prevent an SLC.

*Could low turnover independents be targeted with worse terms of supply?*

6.20 It might be argued that independents with relatively low turnover in books (e.g. less than £149,000 per year) are more likely to be locked-in to obtaining a very substantial share of their needs from the wholesale channel. This could be because they purchase insufficient volumes of titles to meet minimum order requirements for publishers on a regular basis. However, we find that low turnover independents do not behave in a markedly different way from high turnover independents.

*Low turnover independents use primary distributors/publishers on a regular basis*

6.21 If low turnover independents were more likely to be “captive”, we would expect them: (a) systematically to use direct supply less than high turnover independents; and (b) to use direct supply rarely. However, these outcomes are not consistent with evidence from Bertram’s survey of over 200 independent bookshops (gathered in the normal course of business).

6.22 First, in many cases it is not clear that high turnover independents use primary distributors/publishers to a greater degree than low turnover independents. For example, [X]% of low turnover independents used a primary distributor/publisher as a secondary or tertiary supplier (when Bertram was the main supplier) which was similar to the [X]% figure for high turnover independents (turnover above £150,000). Further, when asked to cite the second supplier (given that Bertram was the first) low turnover independents mentioned Gardners [X]%, primary distributors/publishers [X]% and THE [X]%. This compares to high turnover independents who mentioned Gardners [X]%, primary distributors/publishers [X]% and THE [X]%. In short, primary distributors/publishers are as important for low turnover retailers as they are for high turnover retailers and, importantly, seem to be almost three times more important than THE.

6.23 Secondly, low turnover independents use primary distributors/publishers to a large degree. For example, [X]% of low turnover independents used a primary distributor/publisher as one of their three main sources of supply in 2006 (compared to [X]% for high turnover independents).

6.24 This is consistent with the view that independents across the board use direct supply to a substantial degree and therefore primary distributors/publishers are likely to act as a competitive constraint on wholesalers. As such, it is reasonable to believe that the 50% share of the independent segment held by direct supply, is representative for both small and large independents. That is to say, the evidence does not support the OFT assertion that a large share of independents rely on wholesalers for at least 80% of their needs.

*Low turnover independents cannot be identified and targeted systematically*

6.25 Another factor that makes it hard to identify “captive” low turnover independents is that, often, Bertram and THE do not know whether a retailer has low volumes with Bertram or THE because it has a low turnover in books, or whether the low volume purchased reflects the fact that most of the retailer’s needs are sourced from Gardners and primary distributors/publishers. The parties may have some market intelligence on their customers through, for example, visits by sales reps. However, there remains a considerable degree of uncertainty as regards the customer’s overall book purchases and how much is placed with other suppliers.

6.26 Further, [REDACTED]

**Figure 1: Bertram & The Discount vs. Sales (Sales <£300,000)**

[REDACTED]

6.27 [REDACTED]

*Low turnover independents receive the same service as high turnover independents*

6.28 Even if a low turnover independent could be identified, it is not clear how the merged entity could systematically offer that independent a lower service. For example, it is unlikely to be sensible (or, indeed, feasible) to slow delivery times to one customer group over another (especially given that distribution is outsourced and Bertram pays for this service across the board for all deliveries).

***Would the merged entity offer lower discounts depending on the type of book purchased?***

6.29 It might be argued that primary distributors are used by independents only for the supply of certain books (e.g. front-list only, mid-list only, back-list only). However, this is not supported by additional survey evidence which shows that of the 66 out of 71 independent retailers who buy from primary distributors, 48% buy a full range of titles and only 24% source only front-list titles (the fast moving new titles range; see **Table 12**). Intuitively, if the need to achieve low minimum order limits is an issue for some independents, it makes sense to use publishers for all types of titles.

6.30 In any case, the discount structure offered by THE and Bertram is not based on whether a title is front-list, mid-list or back-list. The discount applies for all purchases made and, to the extent that discounts vary, this is due to the trade discount from publishers varying (e.g. Bertram offers a lower discount when its discount from publishers is less than 50%). Thus, if an independent did not source (say) mid-list titles from primary distributors/publishers, the merged entity would have to reduce the discount available on all titles – this would harm its ability substantially to compete with Gardners as well as primary distributors/publishers (for the titles that the independent does source from them).

***Would the merged entity offer lower discounts depending on the “loyalty” of the independent?***

6.31 The OFT cited a [REDACTED] report that claimed that some independents “appear to be very loyal to their principal wholesaler”. However, it is hard to see how the

merged entity would identify the “loyal” customers and treat them in a different way to other independents.

6.32 First, how can “loyalty” be identified? In particular, how can the merged entity tell whether “loyalty” arises because it offers a better deal than Gardners or because the independent has a strong preference for using Bertram/THE and would do so even if prices rose and quality fell? In fact, independents seem to switch in response to small changes in the discount available, supporting the former explanation (as evidenced above).

6.33 Secondly, even if some independents are not price sensitive (being very “loyal” to their particular wholesaler) then if they can be identified they would presumably already be paying the maximum price that they would bear. The merger would not therefore have any impact on their terms of supply.

***The merged firm does not have an incentive to harm independents and, even if it did, consumers would not suffer***

*The merged firm does not have a long term incentive to harm independents*

6.34 The independent segment accounts for a substantial share of the merged entity’s business. Even if it were profitable in the short term to reduce discounts for independents or otherwise deteriorate their terms of supply (which seems unlikely given the discussion above), it is not clear that this would be a profitable strategy in the long run if it would simply speed up the decline of independents.

6.35 Independents account for a large share of wholesaler’s business (the CC estimated this to be around 50% for all wholesalers in *HMV/Waterstone’s/Ottakar’s*, Annex B, paragraph 16) and Bertram sales to independents are [X]% of its UK trade sales. While the merged entity would also sell to supermarkets and internet retailers, these arrangements are inherently unstable (as both channels can switch to direct supply without difficulty). As such, and if the OFT view is correct that some independents are substantially locked in to using wholesalers as their primary supplier, it is not clear that it would be in the interests of wholesalers to take short term profit at the risk of speeding up the decline of the independent sector. Indeed, following the merger customers who had accounts with both Bertram and THE were moved on to the better of the two businesses discounts consistent with the view that the merged firm would not try to harm independents.

6.36 The long term incentive of the merged firm not to further threaten the independent sector is demonstrated when considering the effect on the merged entity of an independent retailer closure.

6.37 In **Table 14** we illustrate the effect of a reduction of £100 in sales from the closure of an independent retailer. A number of assumptions are made:

- (a) Bertram/THE margins are assumed to be [X]% across all distribution channels;
- (b) purchases previously made by retailers at independent retailers (prior to the closure) are still made (i.e. there is no overall reduction in consumption due to the closure); and

- (c) these “diverted” purchases are made via other distribution channels in line with market shares.

6.38 Prior to the merger, Bertram can regain only £[X] of the £100 since it is unable to pick up any margin on the sales diverted to supermarkets and only a very small share of the supply to chains; this implies only [X]% of the margin is regained. Clearly, a loss in sales due to independent closures does not benefit Bertram prior to the transaction as it is unable to recoup these sales elsewhere.

6.39 Considering the same scenario for the merged firm, then we can see that despite THE’s presence in the supply to supermarkets and the slightly higher shares of supply overall, the merged firm still regains only £[X] of the lost £100, i.e. just [X]%. In other words, despite the slight improvement in regained margin, there is no material increase in the incentive to risk harming independent retailers.

**Table 14**

<b>Sales lost</b>		<b>£100</b>	
	Share at retail level	Bertram share of supply	Bertram regained sales
<b>Sales gained by Bertram</b>			
Supermarket	[X]%	[X]%	[X]
Chain	[X]%	[X]%	[X]
Other Indie	[X]%	[X]%	[X]
Non-specialist	[X]%	[X]%	[X]
Internet	[X]%	[X]%	[X]
Book club	[X]%	[X]%	[X]
<b>Total</b>			[X]
		<b>Margin</b>	
<b>Previous margin</b>		[X]%	[X]
<b>New margin</b>		[X]%	[X]
		<b>Margin</b>	
	Share at retail level	Bertram and THE share of distribution channel	Bertram and THE regained sales
<b>Sales gained by Bertram/THE</b>			
Supermarket	[X]%	[X]%	[X]
Chain	[X]%	[X]%	[X]
Other Indie	[X]%	[X]%	[X]
Non-specialist	[X]%	[X]%	[X]
Internet	[X]%	[X]%	[X]
Book club	[X]%	[X]%	[X]
<b>Total</b>			[X]
<b>Previous margin</b>		[X]%	[X]
<b>New margin</b>		[X]%	[X]

Source: Based on TNS data and parties’ estimates

6.40 The risk of closure is substantial. Independents are a vulnerable segment. According to TNS data, the share of independents has declined from 17% in 2001 to 9.0% in 2006 and, whilst market share has remained stable in the past year, the downward trend is expected to continue in the future. The share is not expected to

recover. Further, the responses from independents to the Bertram survey indicate that competition has intensified (while 50% thought competition was the same in 2006 as in 2004, 47% thought it had increased and only 3% thought it had weakened). Independents cite the biggest competitive threats to be the internet (33%), chains (23%), other independents (19%) and supermarkets (15%). Increasing competition from the internet and supermarkets was a feature of the CC's finding in HMV/Waterstone's/Ottakar's<sup>29</sup>.

6.41 The intensity of downstream competition should prevent independents from passing on worse terms of supply to final consumers (as we explain further below). Not only does this guard against consumer harm, it also increases the risk that attempts to charge independents more ultimately speed up the decline of this vulnerable sector.

***Consumers would not suffer even if some independents paid higher prices***

6.42 Even if, hypothetically, some independents would suffer as a result of the merger (which seems highly unlikely due to the competition from Gardners and direct supply), there are good reasons to believe that this would not translate into harm to book-buying consumers due to the intensity of downstream competition from:

- (a) the internet which offers a wider range of books than any independent (often with free delivery and/or at discounted prices) and which has been growing dramatically over the past five years<sup>30</sup>;
- (b) supermarkets which compete keenly on price, especially for the top 500 titles which account for 24% of sales volumes, and which have been growing dramatically over the past five years<sup>31</sup>;
- (c) chains (e.g. Waterstone's/Ottakar's, WH Smith, Borders) which tend to offer a wider range and lower prices than independents and which are forced to offer competitive service levels to differentiate themselves from the increasing constraint placed by internet and supermarket retailers.

6.43 The strength of downstream competition should prevent independents from passing on worse terms of supply to final consumers. Further, since most titles sold by independents are sold at the RRP printed on the cover by publishers, independents cannot pass on worse terms to consumers by increasing prices. The following diagram summarises the factors in the supply chain that safeguard consumer interests in the hypothetical event of independent retailers facing increased prices following the merger.

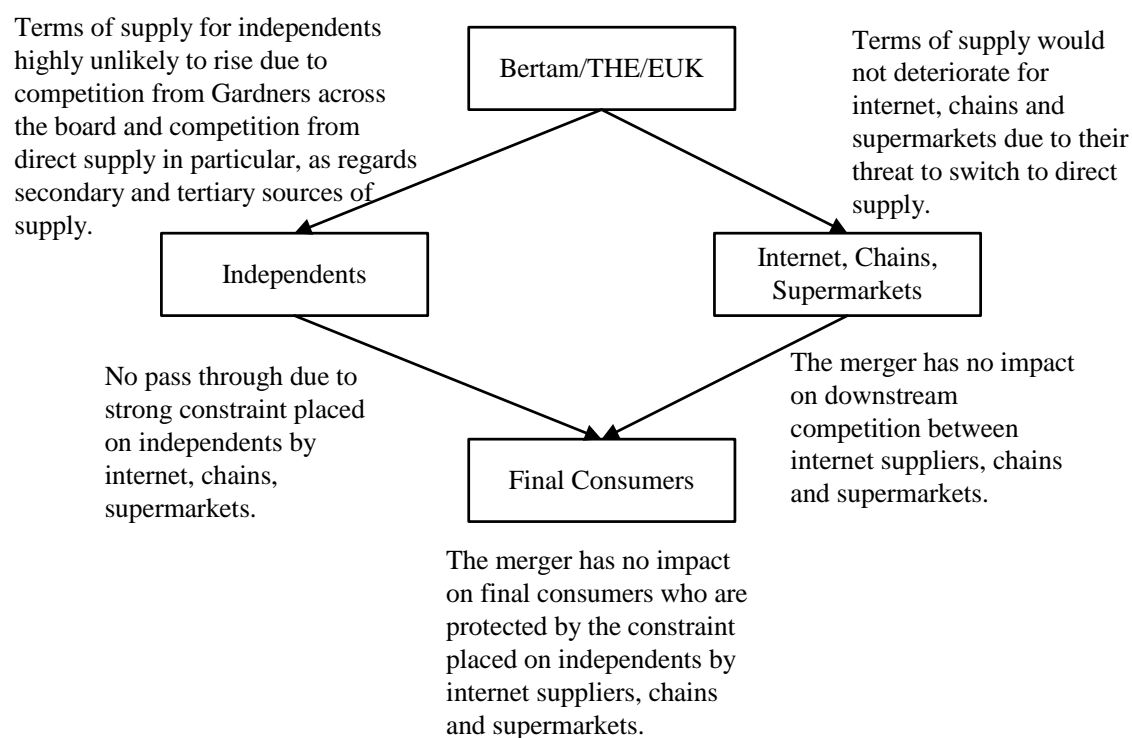
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<sup>29</sup> See, for example, para 29 of the report.

<sup>30</sup> TNS data will be provided in response to the Market Questionnaire which will illustrate this point.

<sup>31</sup> Ibid.

**Figure 2: Safeguards of consumer interests in the supply chain**



***There should be no concerns as to coordinated effects***

6.44 The OFT’s decision to refer the merger does not reach a conclusion with respect to coordinated effects, i.e. on whether Bertram and Gardner operating as “the only two wholesalers” post-merger will cease to compete by tacitly co-ordinating their behaviour.

6.45 In summary, the following paragraphs:

- (a) evaluate the extent to which prices, quantities and service levels are transparent in the wholesale supply of books to independent retailers. Transparency is an essential prerequisite for tacit coordination to occur. It may facilitate reaching a tacit agreement on price and service levels and subsequently makes it possible to detect deviation from the agreed outcome. There is no evidence that there is sufficient transparency in wholesaler terms to support tacit coordination;
- (b) explore whether, if wholesalers were able to reach an agreement, that agreement would be sustainable. For tacit coordination to be sustainable, a credible punishment mechanism must be in place. The OFT did not put forward a credible punishment mechanism and the possible mechanisms that we consider would not appear to be likely or effective;
- (c) look at further characteristics of the supply of books to independent retailers that make tacit coordination between Bertram and Gardner post-merger unlikely. The established presence of publishers as suppliers to independents

and the resulting constraint they exercise on wholesalers supplying independent retailers is evidence that coordination between Gardners and Bertram would not be sustainable.

### ***Lack of transparency in prices, quantities and service levels***

6.46 The evidence on THE and Bertram pricing shows that wholesale suppliers set their discounts and service levels individually and secretly with each of their customers. Bertram does not publish its discount terms and neither do Gardners or THE. There is high variability in discounts agreed even within a given size of retailer. [3<] It would thus be difficult for Gardners to predict accurately the discounts and sales volumes for a competing wholesaler for low turnover accounts. To the extent that larger discounts for larger accounts are more predictable, it should be noted that larger accounts are also better placed to defeat coordinated effects by sourcing direct from publishers or actively playing Bertram and Gardners off against each other.

6.47 The OFT speculates that wholesalers might find out their rivals' discounts through their own negotiations with book retailers. This information is however likely to be distorted by the customer whose interest lies in securing the best discount and service level from the supplier. For example, a customer can exaggerate (e.g. by claiming to have been offered a larger discount than is really the case) as part of its negotiation tactics. Moreover, given that book wholesalers very rarely (if ever) have contracts with independents, it would be hard for a wholesaler to check in any way whether a customer asking for higher discounts or improved terms of supply to match a rival offer had genuinely received a better offer or not. In short, just because independents effectively play wholesalers off against each other to secure better discounts, it does not follow that this means that discount terms are transparent.

6.48 Further, there is a high degree of multi-sourcing amongst independent retailers (as explained in Section 3), who often source part of their stock from publishers or direct distributors. A wholesaler would thus not usually know if a lower than expected volume from a customer was due to: (a) a reduction in retail sales; (b) a switch away from the wholesaler in favour of direct supply; or (c) a switch from the wholesaler in favour of the rival wholesaler. In other words, it would be very difficult for Bertram or Gardners to detect whether the other is deviating from the agreement or whether no deviation has occurred but other market forces are at play.

6.49 In sum, the lack of transparency means that coordinated effects are unlikely. First, given that the information is altogether limited or inaccurate, it would be hard for Bertram and Gardners to *reach an agreement* on the price or service levels. Reaching an agreement would require some form of "signalling" to allow Bertram and Gardners to communicate with each other (i.e. to understand what the agreed coordinated strategy should be). However, the parties would not be able to use price as a signalling mechanism as each signal would be unclear due to the low transparency. Second, it would be very difficult to detect deviation from the agreed price or service level once the agreement would be in place. As such, punishment would never occur and tacit coordination is bound to fail.

### ***Absence of a credible punishment mechanism***

6.50 We have seen above that in the wholesale supply of books to independent retailers, it would be very difficult to tacitly coordinate terms and to observe deviation

from those agreed terms due to the lack of transparency in the market. However, in this section we consider whether such coordination could be sustained, disregarding suppliers' inability to reach an agreement.

6.51 For tacit coordination to arise, a credible mechanism would have to be in place to punish a deviating firm. That is to say, each wholesaler must be willing to forego the extra short term profits available from deviating from the agreed terms of supply due to the fear that this will trigger a punishment phase (such as a price war) and the lower profits associated with that phase. The sustainability of a collusive agreement therefore depends critically on the credibility of the punishment mechanism.

6.52 In the wholesale supply of books to independent retailers a possible punishment mechanism would be to generate a price war by substantially increasing discounts for independent retailers. However, this raises the problem of how to end the price war – i.e. how are discounts subsequently reduced? A wholesaler which increases its customers' discounts without good reason (e.g. without requiring a substantial increase in volumes) weakens its bargaining position at later negotiation rounds thereby making it difficult to reduce discounts. One could envisage a mechanism by which wholesalers would use retroactive discounts as a way to increase discounts for a limited period of time. However, this is somewhat speculative as retroactive discounts are rarely used in practice by Bertram and THE and the discount is obtained only if the target volumes are met (and so prices will not necessarily fall in the punishment phase).

6.53 Given that wholesalers cannot credibly inflict costs onto a deviating rival wholesaler, tacit coordination is highly unlikely. In this regard it should be noted that the OFT could not think of a credible punishment strategy<sup>32</sup>.

#### ***Gardners has increased price competition following the merger proposal***

6.54 Gardners has increased its efforts to attract additional customers since the transaction was announced. It has announced increased discounts and is pro-actively contacting Bertram customers to initiate a switch. Such behaviour is indicative of increased price competition, as opposed to the dampened price competition that would be expected if coordinated effects were likely.

#### ***Publishers are a competitive constraint on wholesalers***

6.55 Publishers and direct suppliers have an established presence as suppliers of books to independent retailers – see Section 3 above. If Bertram and Gardners were to enter into an agreement and sustain prices above the competitive level or reduce service quality, publishers would have a strong incentive to propose better discounts and terms of supply to independents in order to attract their business. Not only would this make detection of deviation difficult (as explained above), it would also defeat the purpose of tacit collusion in the first place by constraining wholesaler terms to remain competitive.

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<sup>32</sup> OFT Decision para 80.

## 7. CONCLUSION

7.1 The merger will not give rise to an SLC in terms of range, price or service quality.

7.2 The evidence supports the contention that Bertram and Gardners are each other's closest competitors:

- (a) Gardners is a stronger constraint on Bertram than is THE (i.e. Gardners constrains Bertram more effectively than THE constrains Bertram); and
- (b) Gardners is no less effective a constraint on THE than is Bertram and probably a stronger constraint by virtue of its greater range (i.e. Gardners constrains THE more than Bertram constrains THE).

7.3 Put differently, to the extent that any independent uses the threat to switch to THE as a way to obtain better terms from Bertram, a more powerful threat remains to switch to Gardners. Likewise, to the extent that any independent uses the threat to switch to Bertram as a way to obtain better terms from THE, an equally (if not more) powerful threat remains to switch to Gardners.

7.4 THE is not a driver of range, price or service quality – these features are driven primarily by competition between Bertram and Gardners.

7.5 Direct supply constrains wholesalers, both in terms of the contest to be the main supplier and, in particular, as regards the contest to be the second supplier. The evidence on demand and supply side substitution is compelling as regards the inclusion of direct supply in the relevant market. Even taking a cautious, narrow market definition that focuses only on the supply of new books to independents, direct supply accounts for at least 50% of the market – substantially in excess of the [X] [20-30]% combined pre-merger share of the parties.

7.6 New entry and expansion is straightforward (although this constraint is not required given the strength of existing competition that remains after the merger). Potential entrants include wholesalers that to date have focussed on other channels (e.g. libraries), as well as foreign distributors that have recently shown an interest in entering the market. Further information will be provided in response to the Market Questionnaire.

7.7 The evidence does not suggest that there is a “captive” base of independents reliant on wholesalers that could be identified and profitably be targeted by the merged firm with worse terms of supply. While some independents may have a strong preference for using wholesalers, such independents are hard to identify because all types of independent use direct supply. Further, “captive” independents would be protected by the competitive strength of Gardners. Indeed, independents using both Bertram and THE were moved on to the *best* of the terms offered by each party as opposed to the worst. This reflects the strength of price competition with Gardners as well as the fact that there is no incentive to weaken the independent sector, given its importance to wholesalers and its vulnerability in the face of intense downstream competition.

7.8 Finally, yet of ultimate importance, it is hard to see how offering worse terms to independents (even if it were possible) would harm final consumers. At the retail

level, supermarkets, the internet and, increasingly, chains provide strong price competition; the internet offers the widest possible range, while chains offer a wider range than most independents; and chains are forced by competition with supermarkets and the internet to maintain competitive levels of service (as the CC recognised in *HMV/Waterstone's/Ottakar's*). In this intensely competitive environment, independent retailers cannot profitably pass through worse terms of supply to final consumers.

7.9 In short, there is no SLC. Independent retailers are not likely to suffer worse terms following the merger and the final book purchasing consumer will not be harmed.

**WOOLWORTHS GROUP PLC  
COMPLETED ACQUISITION OF BERTRAM GROUP LIMITED  
THROUGH ENTERTAINMENT UK LIMITED**

**STATEMENT OF CASE: INDEX OF ANNEXES**

<b>Tab/Annex</b>	<b>Document</b>
1	Segment shares for the supply of books to all retailers via wholesale channel only, for the last 5 years
2	Market shares for the total distribution of books to all retailers via both wholesale and direct supply channels, for the last 5 years

**ANNEX 1: TABLE OF SEGMENT SHARES FOR THE SUPPLY OF BOOKS TO RETAILERS IN THE UK  
VIA THE WHOLESALE CHANNEL ONLY, FOR THE LAST 5 YEARS**

	2006		2005		2004		2003		2002	
	Volume (Units)	Market Share	Volume (Units)	Market Share	Volume (Units)	Market Share	Volume (Units)	Market Share	Volume (Units)	Market Share
EUK/THE*	[X]	[X] [10-20]%	[X]	[X] [30-40]%	[X]	[X] [30-40]%	[X]	[X] [10-20]%	[X]	[X] [10-20]%
Bertram	[X]	[X] [20-30]%	[X]	[X] [10-20]%	[X]	[X] [20-30]%	[X]	[X] [20-30]%	[X]	[X] [20-30]%
<b>EUK/THE/Bertram</b>	[X]	[X] [40-50]%	[X]	[X] [50-60]%	[X]	[X] [50-60]%	[X]	[X] [30-40]%	[X]	[X] [30-40]%
Gardners	[X]	[X] [40-50]%	[X]	[X] [30-40]%	[X]	[X] [30-40]%	[X]	[X] [40-50]%	[X]	[X] [30-40]%
Handleman	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%
Other Wholesalers	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [10-20]%	[X]	[X] [10-20]%
<b>Total Segment</b>	<b>53,844,559</b>	<b>100%</b>	<b>65,976,777</b>	<b>100%</b>	<b>58,130,027</b>	<b>100%</b>	<b>54,154,521</b>	<b>100%</b>	<b>55,233,939</b>	<b>100%</b>

	2006		2005		2004		2003		2002	
	Value (£)	Market Share	Value (£)	Market Share	Value (£)	Market Share	Value (£)	Market Share	Value (£)	Market Share
EUK/THE*	[<]	[<] [10-20]%	[<]	[<] [20-30]%	[<]	[<] [20-30]%	[<]	[<] [10-20]%	[<]	[<] [10-20]%
Bertram	[<]	[<] [20-30]%	[<]	[<] [20-30]%	[<]	[<] [20-30]%	[<]	[<] [20-30]%	[<]	[<] [20-30]%
<b>EUK/THE/Bertram</b>	[<]	[<] [40-50]%	[<]	[<] [50-60]%	[<]	[<] [50-60]%	[<]	[<] [30-40]%	[<]	[<] [40-50]%
Gardners	[<]	[<] [40-50]%	[<]	[<] [40-50]%	[<]	[<] [40-50]%	[<]	[<] [40-50]%	[<]	[<] [40-50]%
Handleman	[<]	[<] [0-10]%	[<]	[<] [0-10]%	[<]	[<] [0-10]%	[<]	[<] [0-10]%	[<]	[<] [0-10]%
Other Wholesalers	[<]	[<] [0-10]%	[<]	[<] [0-10]%	[<]	[<] [0-10]%	[<]	[<] [10-20]%	[<]	[<] [10-20]%
<b>Total Segment</b>	<b>398,525,440</b>	<b>100%</b>	<b>462,519,031</b>	<b>100%</b>	<b>416,455,550</b>	<b>100%</b>	<b>404,661,884</b>	<b>100%</b>	<b>373,296,885</b>	<b>100%</b>

Source: TNS data (for total market size), publicly available turnover information and parties' actual sales data and estimates to reflect wholesaler shares of supply.

\* [<]

**ANNEX 2: TABLE OF MARKET SHARES FOR THE SUPPLY OF BOOKS TO RETAILERS IN THE UK  
VIA DIRECT AND WHOLESALE CHANNELS, FOR THE LAST 3 YEARS**

	2006		2005		2004		2003		2002	
	Volume (units)	Share	Volume (units)	Share	Volume (units)	Share	Volume (units)	Share	Volume (units)	Share
EUK/THE*	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%
Bertram	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%
<b>EUK/THE/Bertram</b>	[X]	[X] [0-10]%	[X]	[X] [10-20]%	[X]	[X] [10-20]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%
Gardners	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%
Handleman	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%
Other Wholesalers	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%
Tesco (Direct Supply)	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%
Other Direct Supply	[X]	[X] [70-80]%	[X]	[X] [70-80]%	[X]	[X] [70-80]%	[X]	[X] [70-80]%	[X]	[X] [70-80]%
<b>Total Market</b>	<b>297,228,877</b>	<b>100%</b>	<b>286,188,158</b>	<b>100%</b>	<b>277,045,045</b>	<b>100%</b>	<b>266,817,789</b>	<b>100%</b>	<b>258,274,515</b>	<b>100%</b>

	2006		2005		2004		2003		2002	
	Value (£)	Share	Value (£)	Share	Value (£)	Share	Value (£)	Share	Value (£)	Share
EUK/THE*	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%
Bertram	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%
<b>EUK/THE/Bertram</b>	[X]	[X] [0-10]%	[X]	[X] [10-20]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%
Gardners	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%
Handleman	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%
Other Wholesalers	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%
Tesco (Direct Supply)	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%	[X]	[X] [0-10]%
Other Direct Supply	[X]	[X] [70-80]%	[X]	[X] [70-80]%	[X]	[X] [80-90]%	[X]	[X] [80-90]%	[X]	[X] [80-90]%
<b>Total Market</b>	2,234,512,000	<b>100%</b>	2,205,788,000	<b>100%</b>	2,159,150,000	<b>100%</b>	2,112,660,000	<b>100%</b>	2,006,355,650	<b>100%</b>

Source: TNS data (for total market size), publicly available turnover information and parties' actual sales data and estimates to reflect wholesaler shares of supply.

\* [X]

**Woolworths Group plc**

**completed acquisition of**

**Bertram Group Limited**

**through**

**Entertainment UK Limited**

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**Statement of Case**  
**(Non-confidential version)**

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**1 May 2007**



**FRESHFIELDS BRUCKHAUS DERINGER**